United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-7243

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

B
P/S

AUBREY B. LANK, as Receiver of PICKARD & COMPANY, INCORPORATED,

Plaintiff-Appellee,

-against-

THE NEW YORK STOCK EXCHANGE,

Defendant-Appellant.

On Appeal pursuant to 28 U.S.C. §1292(b) from the United States District Court For the Southern District of New York (71 Civ. 5525)

BRIEF FOR PLAINTIFF-APPELLEE

SPENGLER CARLSON GUBAR CHURCHILL & BRODSKY
Attorneys for Plaintiff-Appellee
280 Park Avenue
New York, New York 10017
Tel. No.: (212) 682-4444

Of Counsel:

ROBERT S. CARLSON
WILLIAM F. TUETING
GREGORY KATZ
ROBERT D. MARAFIOTI

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AUBREY B. LANK, as Receiver of PICKARD & COMPANY, INCORPORATED,

Plaintiff-Appellee,

-against-

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On Appeal pursuant to 28 U.S.C. §1292(b) from the United States District Court For the Southern District of New York (71 Civ. 5525)

BRIEF FOR PLAINTIFF-APPELLEE

ISSUES PRESENTED

The questions of law certified by the District Court for immediate appeal pursuant to 28 U.S.C. §1292(b) are:

(1) Whether the receiver of a former member corporation of the New York Stock Exchange, Inc. (the "Exchange"), a national securities exchange,

has standing (or alternatively "capacity") to assert a claim against the Exchange under Section 6 of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78f, on behalf of the member corporation, and

(2) Whether a three year or six year statute of limitations is applicable to the receiver's claim under Section 6. (JA-248a)*

STATEMENT OF THE CASE

This is an action by the Plaintiff-Appellee (the "Receiver" or "Lank") as the receiver of an insolvent Delaware corporation which was formerly a member firm of the defendant-appellant Exchange to recover damages suffered by the corporation as a result of the Exchange's failure to perform the obligations it assumed pursuant to Section 6 of the Exchange Act. The Exchange was granted this interlocutory appeal pursuant to 28 U.S.C. §1292(b) on two questions certified by the District Court (per Lasker, J.).

A. Procedural History of Receiver's Claim Against the Exchange

Aubrey B. Lank was appointed Receiver of Pickard & Company, Incorporated ("Pickard") on April 22, 1969 by order of the Court of Chancery of the State of Delaware. (JA-89a) Pickard, a Delaware corporation, was formerly a registered broker-dealer, investment advisor and member firm of the

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* References are to pages of the Joint Appendix.

Exchange. On February 13, 1968, Pickard ceased conducting a general securities business and, since that time, Pickard's only activity has been its own liquidation. (JA-7a)

On May 21, 1968, Lloyd W. McChesney, then also Chief Examiner of the Exchange, was made Liquidator of Pickard, pursuant to an agreement between Pickard, the voting shareholders of Pickard and the Exchange. (JA-30a) The Exchange's Liquidator managed the affairs of Pickard until the appointment of the Receiver in April 1969 upon the Petition of the Exchange, as a creditor of Pickard, in the Delaware Chancery Court. (JA-89a)

On or about July 24, 1970, the Exchange filed a claim as a creditor of Pickard for $227,007.51 against the Receiver in the Delaware receivership proceeding. (JA-98a) In April 1971, the Receiver, with the permission of the Delaware Chancery Court, filed a counterclaim against the Exchange (JA-94a) in which he sought substantially the same relief he now seeks in the complaint in this action. (JA-6a, 95a) The Chancery Court, in an opinion dated September 20, 1971, granted a motion by the Exchange to dismiss the counterclaim upon the ground that exclusive jurisdiction over such claim rested in the federal courts. New York Stock Exchange v. Pickard & Co., Inc., 282 A.2d 651, JA-101a (Del. Ch. 1971).

In December 1971, three months after the Delaware counterclaim was dismissed, the Receiver commenced this federal

action. (JA-4a) The Exchange counterclaimed against the Receiver on the same theory and for the same amount which it stated in its claim in the Delaware receivership proceeding. (JA-20a)

The thrust of the complaint is that the Exchange knew or should have known as early as October 1966 that Pickard was in violation of the Exchange's net capital and other rules and that, had the Exchange fulfilled its obligations under the agreement formed pursuant to Section 6 of the Exchange Act, Pickard would not have suffered certain damages, including $650,000 in defalcations by certain of its officers. (JA-6a)

In October 1972, the Exchange moved in the Delaware Chancery Court to compel the Receiver to terminate the instant action on the ground that it constituted a waste of receivership assets. The Exchange's motion was denied by the Chancellor in a written opinion. (JA-110a)

In April 1975, the Exchange moved in the District Court for (i) summary judgment dismissing the complaint on the grounds of the Receiver's lack of standing and the bar of the statute of limitations and (ii) summary judgment on its counterclaims. (JA-26a)

The court below (405 F.Supp. 1031, JA-215a) sustained the Receiver's standing to assert claims under Section 6 on behalf of Pickard and held the six-year statute of limitations

for contractual obligations (N.Y. CPLR §213(2)) to be applicable to the Section 6 claim. The Court also granted summary judgment as to liability on two of the Exchange's counterclaims. (JA-215a) The Exchange appeals, pursuant to 28 U.S.C. §1292(b), from the order of the court below.

B. <u>Events Leading to the Receivership Proceeding</u>*

On January 11, 1966, Pickard and certain of its officers were censured for violations by Pickard of the Exchange's capital requirements occurring from June 30, 1965 to July 15, 1965 and warned that another violation might lead to more drastic disciplinary action.

As the result of an again unsatisfactory capital condition in June 1966 and inadequate records, Pickard agreed with the Exchange on June 30, 1966, pending clarification of its capital condition, to restrict its operations until further notice. Pickard agreed not to:

1. Trade for the Pickard account except for "riskless" transactions to fill customer over-the-counter orders;

2. Hire any additional registered representatives;

3. Open any new branch offices;

4. Accept any new margin accounts with significant debit balances;

---

* This section contains a summary of relevant portions of the Exchange's Memorandum found at JA-165a, JA-168a to JA-172a.

5. Engage in underwritings other than those to which Pickard was irrevocably committed; and

6. Effect any new transactions for Pickard's option conversion account.

In connection with these violations on, February 7, 1976 certain officers of Pickard were again censured and Pickard was fined $5,000. The Exchange's Advisory Committee also continued until further notice the special restrictions.

The censure closed with a statement that "[s]hould there be any evidence in the future of your inability to conduct your corporation's affairs in accordance with the Rules and Regulations to which it is subject, it may result in formal proceedings before the full Board of Governors leading to suspension or expulsion." (JA-170a)

On March 30, 1967, the National Association of Securities Dealers, Inc. censured Pickard and imposed a fine of $3,000 as a result of its finding that Pickard was guilty of failing to register certain employees and charging excessive markups on principal transactions with customers during the period June 1965 through June 1966.

The Exchange modified the restriction it imposed on trading in the account of Pickard to permit a trading limit of not more than $100,000 covering transactions which were not of a "riskless" nature.

A subsequent visit to Pickard by an Exchange Examiner disclosed:

1. A violation of the Exchange's net capital rule on June 30, 1966;

2. A violation of an agreement with the Exchange to maintain net capital of at least $25,000 in excess of minimum requirements or an amount which would provide a ratio of aggregate indebtedness to net capital of not more than 1500 percentum, whichever was the greater dollar "cushion";

3. A violation of the Exchange's Rule 402 in failing to segregate customers' securities properly and promptly;

4. A violation of SEC Rule 240.8c-1 in commingling customers' securities in bank loans without the written consent of each customer;

5. A violation of the Exchange's Rule 405(3) in failing to approve in writing the opening of new accounts;

6. A violation of Regulation T in failing to cancel or otherwise liquidate 18 purchases in customers' special cash accounts where full cash payment had not been obtained within the statutory period;

7. A violation of the "freeze" provisions of Regulation T;

8. A violation of SEC Rules 17a-3 and 4 in failing to maintain current and accurate records involving customers' ledger accounts, stock records, fail to receive and deliver records, and other records;

9. A violation of NASD rules relating to supervisory procedures.

In September 1967, pursuant to a rule of the Exchange, Haskins & Sells began a review of Pickard's financial condition but was unable to complete its audit within the period allowed by the Exchange rules. Periodic extensions of the deadline for submitting the audit were granted by the Exchange until December 1967. (JA-33a)

C. <u>Liquidation and Receivership</u>

In February 1968, the Exchange finally curtailed Pickard's operations and, in May 1968, appointed its Chief Examiner as Liquidator of Pickard. The Liquidator proceeded to settle claims of Pickard's customers with assets of Pickard, Exchange funds and funds borrowed from the Special Trust Fund of the Exchange (JA-32a) until the Receiver was appointed in April 1969. (JA-89a)

STATUTES INVOLVED

Section 6 of the Exchange Act as enacted and in effect at all relevant times provided as follows:

> "Sec. 6(a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:
>
> (1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this chapter, and any amendment thereto and any rule or regulation made or to be made thereunder;
>
> (2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;
>
> (3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and
>
> (4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.
>
> (b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and

declare that the willful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this chapter shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this chapter and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this chapter and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an aplication for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

The relevant portions of the statutes of limitations of the New York Civil Practice Law and Rules are:

§213. <u>Actions to be commenced within six years:</u> The following actions must be commenced within six years:

* * *

2. an action upon a contractual obligation or liability express or implied....

* * *

§214. <u>Actions to be commenced within three years:</u> The following actions must be commenced within three years:

* * *

2. an action to recover upon a liability, penalty or forfeiture created or imposed by statute ....

* * *

ARGUMENT

POINT I

<u>THE DELAWARE RECEIVER OF A FORMER MEMBER CORPORATION OF THE EXCHANGE HAS STANDING AND CAPACITY UNDER BOTH DELAWARE LAW AND FEDERAL LAW TO ASSERT A CLAIM AGAINST THE EXCHANGE UNDER SECTION 6 OF THE EXCHANGE ACT.</u>

Although the issue has only recently been resolved, it is now clear, for reasons both of statutory construction and of legislative intent and policy, that a receiver of a former member corporation of the Exchange has power under Delaware law, and standing under the Exchange Act, to assert a claim for the Exchange's failure to fulfill the obligations it assumed pursuant to Section 6 of the Exchange Act. The

pursuit of such a claim by the Receiver clearly accords with the equitable remedies granted receivers at common law, with the rights of private parties under the securities laws and with the express purpose of the Exchange Act "to provide for the regulation of securities exchanges ..., to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)

A. The Receiver has power under Delaware law to bring this action.

The District Court below correctly determined, after reviewing Delaware and common law authorities, that the Receiver has power under Delaware law to prosecute actions on behalf of a corporation "to preserve, collect, administer and distribute the property of a corporation," (JA-222a) citing 2 Clark, Receivers § 578 (3rd ed. 1959).* In general, a receiver may prosecute any action which the corporation could have brought had it remained a going concern. 16 Fletcher, Cyclopedia of Corporations § 7847 (1962 rev. ed.). In certain instances the receiver is even granted causes of action not available to the

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* The Delaware statute pursuant to which the Receiver was appointed expressly authorizes him to:

> "take charge of [the corporate] assets ... and to collect the outstanding debts, claims and property due and belonging to the corporation, with power to prosecute and defend ... all claims or suits ... and to do all other acts which might be done by the corporation." 8 Del. Code Ann. §291 (1975).

corporation and is permitted to sue free of certain defenses usually available against a corporation, 16 Fletcher, Id. §7847-7848.

These principles were enunciated in two Delaware cases relied upon by the District Court in its decision below (JA-228a) and by the Delaware Chancellor in his denial of the Exchange's motion to dismiss this action. (JA-110a)

In Bovay v. H. M. Byllesby & Co., 26 Del. Ch. 69, 22 A.2d 138 (1941), the Chancery Court found that a receiver could sue to recover for a fraud perpetrated on an insolvent corporation by persons occupying a fiduciary relation to it. The Court recognized that when a corporation is insolvent its creditors, and not its stockholders, are ordinarily primarily interested in its assets.

Similarly, the Court of Chancery in Keedy v. Sterling Electric Co., 13 Del. Ch. 66, 115 A. 359 (1921), held that a receiver was not subject to defenses that would be sufficient against the corporation where the receiver sought to set aside an allegedly fraudulent conveyance of corporate property.

The Delaware Chancellor denied the Exchange's motion to compel termination of this action on the grounds that it was a waste of receivership assets, stating that:

> " . . . [T]he Receiver argues that when an insolvent corporation has perpetrated a fraud on its creditors by an illegal and improper disposition of its assets, its receiver may enforce the rights of creditors and, in so doing, has even greater rights than the

> corporation would have had. And so he has under Bovay and other cases based upon fraudulent transfers and under various circumstances when the corporation could not recover. [Citations omitted]." (JA-111a)

In this case where the misappropriation of $650,000 was made possible by the failure of the Exchange to perform its obligations under Section 6, the Chancellor concluded (in 1972 when the judicial authority supporting standing under Section 6 was developing) that the Receiver should be given an opportunity to recover the corporate assets in a federal court. (JA-113a)

The District Court correctly concluded that the Receiver here is suing to recover corporate damages in the interest of its creditors, and that in so doing he is simply acting in accordance with his statutory mandate to "maximize the pool of corporate assets in order to satisfy the corporation's obligations to the greatest extent possible." (JA-228a) The Court found there to be no difference between allowing recovery from the fraudulent transferee and permitting recovery from the party, in this case the Exchange, whose actions permitted the fraudulent transfer to occur.

The Exchange cites (Appellant's Brief, pages 6-7) three cases which it asserts stand for the proposition that the Receiver has no power under Delaware law to bring this action. None of the cases supports this assertion, nor is any relevant to whether the Receiver has a federal, rather than a state, cause of action.

In Asmussen v. Quaker City Corp., 18 Del. Ch. 28, 156 A. 180 (1931), the Court sustained a demurrer to the petition for the appointment of a receiver to recover assets transferred by a corporation while insolvent on the ground that there was no reason to appoint a receiver since the transfers were entirely permissible. The Court concluded, in the penultimate paragraph of its opinion, which the Exchange incorrectly summarized (Appellant's Brief, pages 6-7), that:

> "The result of the foregoing is that if a receiver were appointed in this case, he could not accomplish the only end which, according to the bill, his appointment is designed to serve. This result is arrived at without regard to the question of whether the right of action which the complainant would desire a receiver to assert is one that belongs to the corporation, which he would represent, or to the complainant in his individual right, a question which was suggested at the argument, but one which, because of the foregoing, I need not pass upon."

In In re Frederica Water, Light & Power Co., 10 Del. Ch. 362, 93 A. 376 (1915), the only question at issue was not the standing of a receiver to sue but rather one of priorities between a conditional vendor of a water tower and the mortgagee with respect to the possession of the water tower constructed on the mortgaged land. The case has absolutely nothing to do with the power of a receiver, except for a passage where the Court indicated that it was making a ruling of law rather than applying equitable principles:

"This question is to be determined as though raised between individuals, for the possession taken by the receiver is only that of the court, whose officer he is, and he takes what the corporation had and no more. Furthermore, the court is adjudicating legal rights." (93 A. at 377)

In the third case cited by the Exchange, Delaware Trust Co. v. Elder & Co., 12 Del. Ch. 263, 112 A. 370 (1920), the dispute was between a conditional vendor and the receiver for the vendee. In an action by the vendor under the Uniform Conditional Sales Act, the receiver had pleaded as a defense that the vendor had not recorded its contract as required by statute. The Court quite simply said that under then-existing law the receiver was not in a position of a bona fide purchaser for value and, therefore, could not take advantage of the recording section of the statute.

Thus, it is clear from Delaware law that the receiver has power to bring actions to recover assets for the estate which would accrue to the benefit of corporate creditors where such a right exists in the corporation.

B. The Receiver has a recognized claim for relief against the Exchange for its failure to perform duties it assumed pursuant to Section 6.

It has been recognized since Baird v. Franklin, 141 F.2d 238 (2d Cir.), cert. denied, 323 U.S. 737 (1944), that a private right of action under Section 6 of the Exchange Act exists against the Exchange -- in that case in favor of a

customer of a member firm. In recent years, the right has been found also to exist not only in a receiver as in this action, but also in limited partners of a broker-dealer. New York Stock Exchange, Inc. v. Sloan, 394 F. Supp. 1303 (S.D.N.Y. 1975); Miller v. New York Stock Exchange, Inc., CCH Fed.Sec.L. Rep. ¶95,606 (S.D.N.Y. June 4, 1976); Weinberger v. New York Stock Exchange, 335 F. Supp. 139 (S.D.N.Y. 1971) (Gurfein, J.) and 403 F. Supp. 1020 (S.D.N.Y. 1975) (Bonsal, J.), in subordinated lenders and investors, Hughes v. Dempsey-Tegeler & Co., Inc., [1973 Transfer Binder] CCH Fed.Sec.L.Rep. ¶94,133 (C.D. Cal.), aff'd, 534 F.2d 156 (9th Cir. 1976) and Carr v. New York Stock Exchange, [1975-76 Transfer Binder] CCH Fed.Sec.L. Rep. ¶95,563 (N.D. Cal. May 3, 1976), even in a member of the exchange itself, Bright v. Philadelphia-Baltimore-Washington Stock Exchange, 327 F. Supp. 495 (E.D. Pa. 1971), and in the reorganization trustee of a corporate issuer, Pettit v. American Stock Exchange, 217 F. Supp. 21 (S.D.N.Y. 1963).

Recently, the decision of the Court below in this action was analyzed and followed in Collins v. PBW Stock Exchange, Inc., 408 F.Supp. 1344 (E.D.Pa. 1976) where the court found, in a situation identical to this one, that the Trustee of the estate of a member corporation did have standing to assert a Section 6 claim against an exchange. The court, in a careful opinion, recognized that it effectuates the policy of the

Exchange Act to permit such a claim to be asserted. The oft-made and oft-rejected argument of the Exchange that a private right of action under the Exchange Act must be narrowly limited was also considered, and recognized as a plaintive plea that the law should not develop to deal with new and novel problems.

The only Section 6 standing case the Exchange approves, apparently, is Caddell v. Goodbody & Co., [1973 Transfer Binder] CCH Fed.Sec.L.Rep. ¶93,938 (N.D. Ala. 1972), a case with unusual facts. There, the plaintiffs sued the Exchange, Goodbody and others alleging that a partner of Goodbody, who negotiated the sale of two companies owned by plaintiffs, was financially interested in the buyer and misrepresented both Goodbody's plans for the buyer and Goodbody's own financial condition. The Court found that Goodbody's alleged technical violations of Exchange rules did not affect plaintiffs, and dismissed the counts against the Exchange.

In a situation analogous to the instant case, the bankruptcy trustee of a commodities broker was found to have a right of action against a commodities exchange for its failure properly to regulate the commodities markets. Seligson v. New York Produce Exchange, 378 F. Supp. 1076 (S.D.N.Y. 1974), appeal docketed sub nom. Miller v. New York Produce Exchange, No. 75-5024 (2d Cir. February 2, 1976).

It is this line of cases beginning with Baird, supra, which the Exchange is seeking to overturn with its time-worn argument that, since public customers are among the persons Congress sought to protect with the passage of the Exchange Act, they are the only persons with a cause of action under Section 6.

Citing many of the cases listed above, the District Court found that "a corporation, like the customers, subordinated lenders and limited partners of a brokerage firm, is required by its status to rely on those responsible for the management of the firm to comply with the net capital rule and is therefore entitled to the Exchange's diligent enforcement". (JA-226a) The Court concluded that since a member corporation as an entity can be damaged if those who control it violate the rules promulgated by the Exchange pursuant to Section 6, the member corporation is entitled to the benefits and protection of Section 6 and, accordingly, its Receiver has standing to sue.

In recognition of the strength of Judge Lasker's opinion and of the line of cases cited above, the Exchange has turned to the shifting sands of legislative history (using arguments Judge Lasker rejected below and in Sloan, supra), and a one-line quotation, out of context, from the recent Supreme Court opinion in Cort v. Ash, 422 U.S. 66 (1975), in an attempt to stem the tide. Cort simply does not bear the weight the

Exchange would put on it, and, in fact, its analysis of implied private rights of action clearly supports the decision below.

C. The District Court's holding that the Receiver has an implied right of action is supported by precedent.

In Cort, the Supreme Court enunciated several theories which had been used to imply private rights of action. First, is the plaintiff one of the class for whose especial benefit the statute was enacted? Second, was there an indication of legislative intent to create such a remedy or deny one? Third, is it consistent with the underlying purpose of the legislative scheme to imply such a remedy for plaintiff? And, fourth, is the cause of action one traditionally relegated to state law, in an area basically the concern of the state?

The Exchange implies that each of these "several factors" which the Supreme Court states are "relevant" in finding a private right of action, Cort, 422 U.S. at 78, is an essential condition which must be met before a private right of action is implied. Clearly, the case does not stand for this proposition. What it does say is that an analysis of the four factors enunciated is helpful in determining whether a private right of action is appropriate in any given instance. Each of the Cort factors and the precedents underlying them mandate an affirmance of the decision of the District Court below.

The legislative intent in passing the Exchange Act was to provide for self-regulation of the securities markets

by registered securities exchanges. Part of the statutory scheme, as embodied in Section 6, was to impose duties on the Exchange to regulate member firms and thereby protect and preserve orderly capital markets and investor confidence. Silver v. New York Stock Exchange, 373 U.S. 341 (1963).

As the Supreme Court observed in Cort, 422 U.S. at 82, where a federal private cause of action, not expressly provided, has been inferred there has generally been a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard. See, e.g., J.I. Case Company v. Borak, 377 U.S. 426 (1964). Certainly that factor is present in the regulatory scheme between the Exchange and its member firms.

In fact, the Exchange Act was divided into two titles. Title I in which Section 6 appears was denominated "Regulation of Securities Exchanges". See, e.g., Blue Chip Stamps v. Manor Drug Stores, supra. Section 6, within this Title I, imposed obligations upon national securities exchanges to formulate rules governing the conduct of exchange members. See Silver v. New York Stock Exchange, supra.

It is precisely because the Exchange's own regulation of its members failed to achieve the purposes of the Exchange Act that Pickard was damaged and the Receiver is seeking to

recover corporate losses from the Exchange.*

The Exchange's allegations that no losses were suffered by the public customers of Pickard are of no legal consequence on this motion directed to the pleadings and it is purely fortuitous that the Exchange and its special Trust Fund were able to advance the monies, at that early phase of the Wall Street crisis, to pay them off. Indeed, the Trust Fund gave out in 1970 following one of the worst crises in Wall Street history. The depth of the crisis, which was accompanied by the collapse or forced merger of more than 160 member firms, has been attributed, in large part, to the failure of the Exchange properly to regulate its members. See, generally, Note, "Exchange Liability for Net Capital Enforcement," 73 Col.L.Rev. 1262 (1973).

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* The Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce in its Securities Industry Study, H.R. Rep. No. 92-1519, 92nd Cong. 2d Sess. (1972) found that the [New York Stock] Exchange's failings were one of the major causes of the operational and financial breakdowns which comprised the 1967-1970 crisis in the securities business. In evaluating the Exchange and its net capital rule the Securities Industry Study concluded that "both the rule and its enforcement proved sorely deficient when financial responsibility was tested" (Securities Industry Study at 93) and pointed to the Exchange's "failure to meet the statutory goal" (Ibid.). The Subcommittee further observed "the gradual weakening of the New York Stock Exchange's net capital rule removed the substance of protection called for by the Securities Exchange Act, protection which was required because of one market disaster and which, if not so watered down during the 1967-1970 crisis, might have done much to prevent or ameliorate that crisis." (Securities Industry Study at 94-95).

Although Congress did not create express civil remedies under all the sections of the Exchange Act, the courts recognized early that private rights of action were desirable and necessary to effectuate the Congressional policies expressed in the Exchange Act. See, e.g., Blue Chip Stamps v. Manor Drug Stores, supra (tracing the development of a private right of action under Section 10(b); J.I. Case Company v. Borak, supra (finding a private right of action under Section 14); Baird v. Franklin, supra (private right of action under Section 6).

In Case, the Supreme Court stated that private enforcement of the proxy rules provides a necessary supplement to Commission action and that the possibility of civil damages serves as a "most effective weapon" in enforcement. 377 U.S. at 432. The same reasons obviously apply to situations where the Exchange fails in its duty under Section 6.

The same kind of development of the law which occurred with respect to private rights of action under Sections 10(b) and 14 is now occurring with respect to Section 6, in response to a need perceived by the courts for a remedy to effectuate the Congressional mandate imposed on national securities exchanges by Section 6. The force of Judge Lasker's seminal opinion in New York Stock Exchange v. Sloan, supra, has been recognized and followed by several other District Courts and one

Circuit Court.* It nowise strains the legislative scheme of the Exchange Act to allow the receiver to proceed here to marshall the assets of an insolvent member firm for the benefit of all of its creditors. It may even have a salutary effect on the way the Exchange fulfills its obligations under Section 6 in the future. As Judge Lasker stated in Sloan, 394 F.Supp. at 1313:

> "The absence of interested private parties may in some cases have the effect of insulating the Exchange from the consequences of its own negligence. In such circumstances, recognition of a private action by limited partners and subordinated lenders not only provides a remedy for investors with a large financial stake in their firm, but promotes the remedial purposes of the Act."

Clearly, the goal of protecting the public customers of a member corporation is effectuated by allowing a private right of action pursuant to Section 6 in favor of the receiver of a member corporation. In cases arising before the passage of the Securities Investor Protection Act (SIPA), 15 U.S.C. §78aaa, et seq., the public customers of an insolvent member corporation, with limited exceptions, held the status of general creditors, entitled to share the assets of the insolvent corporation with all other general creditors. Obviously any cause of

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* The Exchange would have us believe that other federal judges "simply follow" Judge Lasker (Appellant's Brief, p. 21) without "an independent analysis of the standing question". It is more likely that these federal judges thoroughly considered the standing question and concluded that New York Stock Exchange v. Sloan, supra, and its progeny were correctly decided.

action on which the recovery would increase the assets of the insolvent's estate would redound to the especial benefit of the public customers as creditors of an insolvent corporation like Pickard.*

The reliance by the Exchange on the passage of SIPA as evidence that a right of action pursuant to Section 6 should be implied only in favor of public customers is wholly misplaced for the reason that SIPA was passed, in part, to remedy the failure of the Exchange to perform its duties assumed pursuant to Section 6. Moreover, the insurance created for public customers by SIPA does not benefit the public customers of broker-dealers who went out of business before its effective date, are limited in amount, and provide no benefits for the other general creditors of an insolvent broker-dealer.

Finally, the Receiver's cause of action is certainly not one traditionally relegated to state law. In this case, the Delaware court has already decided that state law does not provide a remedy by dismissing on the ground of exclusive federal jurisdiction the Receiver's counterclaim pursuant to Section 6. New York Stock Exchange v. Pickard & Co., Inc.,

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* Even in cases where the SIPA is applicable, the amount to be paid to any one public customer by the Security Investor Protection Corporation, is limited and if a customer's loss exceeds the statutory amounts, he must generally then share, as a general creditor, in the general assets of the broker-dealer.

supra. Thus, this is the only forum, and this action provides the only means, for the Receiver to assert a claim against the Exchange based on Section 6.

The Exchange laments, in conclusion, that to require it to fulfill the obligations it assumed under Section 6 subjects it to undeserved burdens and "conflicting liabilities" (Appellant's Brief, pages 30-33). In _Hughes v. Dempsey-Tegeler & Co., Inc._, 534 F.2d at 170, the Ninth Circuit considered this question at length and concluded:

> "As long as the Exchange takes prompt action to investigate alleged violations, and, having ascertained that violations exist, takes action reasonably designed to restore compliance with the rules, courts should not substitute the retrospective judgment concerning the appropriate action. The evaluation of an Exchange's response to a violation of its rules must be made in the light of all the circumstances of the particular case."

When the Receiver's claim is finally considered on the merits, the Exchange will have ample opportunity to show that it fulfilled the agreement it entered into with the SEC to perform its regulatory role.

This Court should answer the first certified question affirmatively and find that the Receiver does have standing to recover damages from the Exchange for its failures to carry out its obligations under Section 6.

POINT II

A SIX-YEAR STATUTE OF LIMITATIONS IS APPLICABLE TO THE RECEIVER'S CLAIM UNDER SECTION 6.

A. The District Court correctly followed settled law in applying the six-year contract statute of limitations.

The District Court below held that the Receiver's Section 6 claim is governed by the six-year statute of limitations for actions "upon a contractual obligation or liability." (N.Y. CPLR §213(2)) The Exchange appeals from this holding, arguing that the claim should be governed by the three-year statute of limitations for actions "to recover upon a liability ... created ... by statute." (N.Y. CPLR §214(2))

The Exchange's position runs directly counter to the weight of the established precedents on this issue, just as it does on the issue of standing. Four New York District Courts, including the lower court herein, have considered the question of which statute of limitations applies to a Section 6 action. All four have held that the six-year statute for actions upon a contractual obligation or liability is applicable. Weinberger v. New York Stock Exchange, supra (Gurfein, J.); Lank v. New York Stock Exchange, supra; Fischer v. New York Stock Exchange, 408 F.Supp. 745 (S.D.N.Y. 1976); Arneil v. Ramsey, [1975-76 Transfer Binder] CCH Fed.Sec.L.Rep. ¶95,550 (S.D.N.Y. May 12, 1976). In addition, two California District

Courts have considered the question. One, in agreement with the New York courts, applied the California contract statute of limitations. Carr v. New York Stock Exchange, supra. The other, faced with the question of whether a Section 6 action was an action for fraud or an action upon a liability created by statute, held that it was the latter. Wilson v. Meyerson, Civ. No. 72-1298 (N.D.Cal. April 6, 1976) The question of whether it might be a contractual action was never considered by that court. Thus, the line of authority is virtually unanimous in applying a contract statute of limitations to Section 6 actions.

Recognizing that its position lacks judicial support, the Exchange attempts to impeach this cumulative line of authority with the assertion that "[e]ach successive court considering the issue has shown a natural reluctance to dispute a co-equal court's holdings and has built on the prior decisions" (Appellant's Brief, page 34). That is a fair description of the special genius of the common law. It is no argument against the validity of the courts' holdings.

The Exchange goes further, however, and attempts to negate the effect of all the cases by undercutting the leading case of Weinberger, supra. In Weinberger, a former limited partner of a member firm of the Exchange sued the Exchange for breach of contract, alleging that he was a third-party beneficiary of the agreement entered into between the Exchange and the SEC pursuant to Section 6(a)(1) of the Exchange

Act.* The Court agreed that the plaintiff was a third-party beneficiary and held that the Section 6(a)(1) agreement achieved "a status of its own as a contract and should be governed by the statute of limitations applicable to contracts." Weinberger, supra.**

The Exchange attacks the opinion in Weinberger on two grounds. The first is that members of the public cannot be third-party beneficiaries of the contract. But that is really an assertion of lack of standing and hence is not directly relevant to the specific issue of which statute of limitations applies to a Section 6 action.*** The second ground is that the precedents relied upon in Weinberger were all distinguishable from the case decided, since they involved contracts "separate from but incorporating terms of the statute"

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* That agreement, filed with the SEC in September 1934 (JA-28a), provided that the Exchange would comply and enforce compliance by its members with the Exchange Act and rules and regulations made thereunder. See, e.g., SEC Form 1, CCH Fed.Sec.L.Rep. ¶27,156.

** Although the original complaint in the present case pleaded a statutory theory of recovery, among others, the court below treated it as though it had pleaded a contract theory, noting that the two claims are for all practical purposes the same and that in any event leave to replead would be freely granted. (JA-235a) The Exchange does not challenge this ruling. (Appellant's Brief, page 39)

*** In the present case, if the Receiver has standing to sue the Exchange, then he is a member of that class of persons which Congress intended Section 6 to benefit, and as such he obviously qualifies as a beneficiary of the Section 6(a)(1) contract.

(Appellant's Brief, page 43) whereas the contract between the SEC and the Exchange allegedly did not exist "outside of the statute" (Appellant's Brief, page 40). But that assertion is conspicuously false. The 6(a)(1) contract was written, signed and filed with the SEC in September 1934. It was formed pursuant to the statute, but once it was formed it clearly existed outside of the statute and achieved, as the Court said, "a status of its own." Weinberger, supra.

Thus, Weinberger was well-founded on its precedents, and the cases which have followed its closely reasoned authority are sound. The decision of the District Court below, applying the six-year contract statute of limitations to this action, was precisely in accord with settled law.

B. The three-year statute of limitations for actions upon a liability created by statute is inapplicable.

The Exchange contends that, notwithstanding settled law to the contrary, Section 6 actions in New York should be subject to the three-year statute of limitations governing actions to recover upon a liability created by statute. That contention is based essentially on the argument that this "action is derived from the statute." (Appellant's Brief, page 36)

N.Y. CPLR §214(2) imposes a three-year limitations period not on actions 'derived from' statute (whatever that may

mean) but on actions 'upon a liability created by' statute. The action in the present case is for breach of contract. The Exchange's liability was created by its breach, or, more exactly, was created by the common law principle that "breach of contract gives rise to a right of action." 11 Williston on Contracts §1290 (3rd ed.).

Liabilities which courts have held to be 'created by statute' have generally been provided for expressly in the statutory language.* Where a liability is not express, a proper test to determine whether it is one created by statute

> "is to determine whether the liability is 'a governmental statutory denouncement of a human action heretofore undenounced' (Fratt v. Robinson, 203 F.2d 627, 635, 37 A.L.R. 2d 636);" Bevelander v. Town of Islip, 10 A.D.2d 170, 172, 199 N.Y.S.2d 561, 564 (2d Dept. 1960).

Section 6(a), pursuant to which the contract herein was formed, of course does not contain any denouncement of any action. But even where a statute does denounce an action, courts have held

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* See, e.g., §4 of the Clayton Act, 15 U.S.C. §15: "Any person ... may sue ... and shall recover threefold the damages" (Bertha Building Corporation v. National Theatres Corporation, 269 F.2d 785 (2d Cir. 1959), cert. denied, 361 U.S. 960 (1960)); the Civil Rights Act, 42 U.S.C. §198.3: "Every person ... shall be liable" (Kaiser v. Cahn, 510 F.2d 282 (2d Cir. 1974)); the Copyright Act, 17 U.S.C. §101: "If any person shall infringe ... such person shall be liable" (Carew v. Melrose Music, 92 F. Supp. 971 (S.D. N.Y. 1950)); §16(b) of the Fair Labor Standards Act, 29 U.S.C. §216(b): "Any employer . . . shall be liable" (Gonzales v. Tuttman, 59 F. Supp. 858 (S.D.N.Y. 1945)).

that the liability implied from the denouncement is not one "created" by statute. Section 10(b) of the Exchange Act, for example, explicitly denominates certain kinds of action as "unlawful," yet suits upon the implied liability arising therefrom have been held subject to the six-year limitations period for fraud rather than the three-year limitations period for liabilities created by statute. Marth v. Industrial Incomes Incorporated of North America, 290 F.Supp. 755, 757 (S.D.N.Y. 1968, Mansfield, J.); Glickman v. Schweickart & Co., 242 F.Supp. 670, 674 (S.D.N.Y. 1965). A fortiori, then, a statute which merely provides that an exchange may be registered with the SEC by following certain steps, one of which is to file a certain agreement, cannot be one which 'creates a liability' as that phrase has been interpreted by the courts.

A private right of action under Section 6 has been held not only to arise from the contract which the Exchange entered into with the SEC pursuant to Section 6(a) but also to arise from Section 6(b) itself (which, together with Section 6(d) impliedly requires exchanges to enforce their rules against member firms). Baird v. Franklin, supra. Although the contents of the statutory 6(b) duty and the contractual 6(a) obligations are effectively the same (see Weinberger, supra, 335 F. Supp. at 144, n. 10; Weinberger, supra, 403 F. Supp. at 1031-32; Hughes v. Dempsey-Tegeler & Co., 534 F.2d at 166, n. 5), a distinction between the two is important for statute of limitations purposes. "[A] single wrong may

give rise to different causes of action," and "in determining which period of limitations applies to a particular cause of action, the criterion is the origin and nature of the liability asserted." Schmidt v. Merchants Despatch Transp. Co., 270 N.Y. 287, 299, 200 N.E. 824 (1936). Strictly speaking, then, it is incorrect to refer broadly to a "Section 6 action" since actions under Sections 6(a) and 6(b), though they may arise from the same act or failure to act, may be subject to different limitations periods . The Receiver here is basing his action on the contract formed pursuant to Section 6(a).

The Exchange contends, however, that "[w]hether the court looks to Section 6(a)(1) or to Sections 6(b) and (d), the action is derived from the statute. Thus, the three year provision must be applied." (Appellant's Brief, page 36). That contention is simply and transparently wrong.

It could be said that the Section 6(a) contract here was derived from the statute, and perhaps even that it was "created" by the statute (in the sense that the statute requires it as an element of registration for national exchanges). But the liability for breach of the Section 6(a) contract is not created by statute. A liability created by statute is one which "did not exist at common law" and which "would not exist but for the statute." Frank Shepard Co. v. Zachary P. Taylor Publishing Co., 234 N.Y. 465, 468, 138 N.E. 409 (1923). Breach of contract has been a legal cause of action since time immemorial. It is

not the creation of Section 6(a), or of any other twentieth-century statute.*

The only kind of "liability" on the part of the Exchange that Section 6(a) might conceivably create would be for failure to file the required agreement with the SEC. But failure to file is not the cause of action here. The Receiver does not claim that the Exchange never entered into the agreement. On the contrary, if the agreement were never entered into it could never have been breached.

What the Exchange violated was not Section 6(a) but the contract formed pursuant to Section 6(a). The liability arose from the breach, not from the statute. Thus, the three-

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* The Exchange cites Platt v. Wilmot, 193 U.S. 602 (1904), Schram v. Cotton, 281 N.Y. 499, 24 N.E.2d 305 (1939), and Hornblower & Weeks-Hemphill, Noyes v. Burchfield, 366 F. Supp. 1364 (S.D.N.Y. 1973), as cases which held that an allegedly contractual liability was in fact created by statute. But Platt and Schram were actions against stockholders of a trust company and a bank who, when they bought the stock, allegedly contracted to assume the same liability that a statute already imposed on them. Moreover, the statute of limitations there imposed a three-year period on actions against stockholders "to enforce a liability created by the common law or by statute" (emphasis supplied). (New York Code of Civil Procedure, §394; New York Civil Practice Act, §49). In other words, the statute of limitations involved in those cases made no distinction between common law and statutory liabilities. Hornblower was an action against a registered broker-dealer for violation of Regulation T of the Federal Reserve Board; the alleged 'contract' was merely that the broker "impliedly promised his customer adherence to federal regulations." Hornblower, 366 F.Supp. at 1367. In contrast, the Exchange's agreement in this case was in writing and expressly promised compliance with a specific law. Thus, the three cases cited by the Exchange offer no guidance for the present case.

year limitations period cannot apply to the present case. The proper period is six years for an action upon a contractual obligation or liability.

C. <u>The application of a six-year statute of limitations to Section 6 actions best effectuates federal policy.</u>

In the absence of a federal statute of limitations the federal courts borrow the state statute of limitations applicable to the most similar state cause of action. <u>Kaiser v. Cahn</u>, 510 F.2d at 284. In deciding which cause of action is most similar, however, the courts look to federal law to determine the nature of the claim, (<u>Moviecolor Limited v. Eastman Kodak Company</u>, 288 F.2d 80, 83 (2d Cir.), <u>cert. denied</u>, 68 U.S. 821 (1961)), in order best to achieve the federal objectives (<u>Douglass v. Glenn E. Hinton Investments, Inc.</u>, 440 F.2d 912, 915 (9th Cir. 1971)) and to prevent a result that would unduly impair a valid federal interest (<u>Kaiser v. Cahn</u>, 521 F.2d at 287). In the present case, then, the court should consider which limitations period is most appropriate for effectuating the purposes of the Exchange Act. <u>International Union United Auto Workers v. Hoosier Cardinal Corp.</u>, 383 U.S. 696 (1966).

Those purposes are "to provide for regulation and control of [securities] transactions and of practices and matters related thereto ... in order to protect interstate commerce, the national credit, the Federal taxing power, to

protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions." 15 U.S.C. §78b. The Exchange Act thus has broad remedial purposes which reach deeply into the economic life of the nation. J.I. Case Company v. Borak, supra. Such purposes are best served by a longer, not a shorter, statute of limitations. United California Bank v. Salik, 481 F.2d 1012, 1015 (9th Cir.), cert. denied, 414 U.S. 1004 (1973); Batchelor v. Legg & Co., 52 F.R.D. 553, 559 (D. Md. 1971). As the District Court pointed out in its opinion below, "[d]iscovery, or even a hint of past failure of a stock exchange to enforce its rules against a member is unlikely to occur until after disaster has struck and there has been an opportunity to investigate the causes." (JA-235a) A short statute of limitations would tend to thwart federal policy by cutting off the remedies of injured parties prematurely.

The Exchange asserts that if the principle to be applied in selecting a statute of limitations is essentially to choose whichever available statute has the longer period, then a Section 6 action may end up being contractual in one state and statutory in another. "National securities exchanges," it asserts, "should not be confronted with such confusion when the choice of the applicable statute is so obvious and rational." (Appellant's Brief, page 44) But the Exchange overlooks the fact that both contractual and statutory periods vary widely

from state to state. What uniformity there is has been created precisely by the tendency of the courts to reach for whichever period is longer and to rationalize their decisions accordingly. See, Einhorn and Feldman, "Choosing a Statute of Limitations in Federal Securities Actions," 25 Mercer Law Review 497 (1974). The Exchange contends that such an approach can lead to "illogic in the law." (Appellant's Brief, page 44) But

> "[s]tatutes of limitations find their justification in necessity and convenience rather than in logic. They represent expedients, rather than principles. They are practical and pragmatic devices." Chase Securities Corporation v. Donaldson, 325 U.S. 304, 314, (1945).

The possible variation in legal theory from state to state would not have consequences serious enough to justify impairing the federal interest in effectuating the broad remedial policies of the Exchange Act.

Nor does the choice of a six-year limitations period in the present case in any way offend state policies. Statutes of limitations are statutes of repose designed to put an end to stale claims. Cameron Estates v. Deering, 308 N.Y. 24, 31, 123 N.E.2d 621 (1954); Gregoire v. G.P. Putnam's Sons, 298 N.Y. 119, 81 N.E.2d 45 (1948). In general, they are intended to promote justice by barring claims after evidence has been lost, memories have faded and witnesses have died or disappeared. Order of Railroad Telegraphers v. Railway Express Agency, 321 U.S. 342, 348-349 (1944). The durability of evidence is pro-

bably the chief reason for the differences in period-length between, for example, actions in tort and in contract: the evidence of a tort is mostly based on the testimony of mortal witnesses, whereas the evidence of a contract is usually a permanent writing. See Roland Electrical Co. v. Black, 163 F.2d 417, 424 (4th Cir. 1947).

In the present case, not only is the agreement between the Exchange and the SEC in writing, but (as the District Court noted) the Exchange has "extensive record keeping practices." (JA-235a) Most of the wrongful acts sued upon here are evidenced by writings.

Moreover, the New York three-year period for actions upon a liability created by statute was introduced only in 1963 with the CPLR. Until then, the period had been six years ever since the Field Code of 1848. The legislature's purpose in making the recent change was primarily to eliminate the problem which courts frequently faced of determining whether a particular statute actually created a new liability (and thus was subject to the six-year period) or whether it merely defined the degree of care to be exercised in pre-existing tort situations (and thus was subject to a three-year period). Weinstein-Korn-Miller, New York Civil Practice, ¶214.05 (1975); McLaughlin, "Practice Commentaries," 7B McKinney's Civil Practice Law and Rules, 428 (1972). The limitations period for actions upon a liability created by statute was thus shortened in New York

not because the legislature decided that the nature of statutory actions inherently demanded a shorter limitations period, or that some deep-rooted public policy was offended by the longer period, but rather because the legislature wished to eliminate, as a matter of practical convenience, a technical but bothersome conflict between two statutes of limitations.

POINT III

SHOULD THE COURT FIND AGAINST THE RECEIVER ON THE STATUTE OF LIMITATIONS ISSUE THIS CASE SHOULD BE REMANDED TO THE DISTRICT COURT FOR RESOLUTION OF THE REMAINING ISSUES

The Exchange seems to suggest (Appellant's Brief, page 45) that a decision favorable to it on the statute of limitations question will terminate the case. To the contrary, although such a decision may advance the ultimate termination of this litigation, it will not terminate it. If this Court should decide that the three-year period of CPLR §214(2) governs, further proceedings in the District Court will be needed to determine how the period is to be applied to the facts of this case.

New York courts have held that a cause of action cannot accrue until there is someone capable of suing on it, see e.g., McCarthy v. Prudential Ins. Co., 252 N.Y. 459 (1930); Callaghan v. Bailey, 38 N.Y.S.2d 203 (Sup. Ct. N.Y. Co. 1942), aff'd, 266 App. Div. 915, 44 N.Y.S.2d 260 (1st Dept. 1943),

aff'd, 293 N.Y. 396 (1944); and that where one person represents both sides of the conflicting claims the statute does not run. Brown v. Brown, 93 N.Y.S.2d 63, mod. on other grounds, 275 App. Div. 1068, 93 N.Y.S.2d 86 (4th Dept. 1949), aff'd, 302 N.Y. 556 (1951). Thus, the District Court will still be compelled to find that the three-year time period only began to run upon the appointment of the receiver in April 1969 and that this action was timely commenced.

Or, should the Receiver's claim be found to be untimely, the District Court will be compelled to find that it must still be allowed as a set-off against the Exchange's counterclaim under the doctrine of equitable recoupment. See generally 1 Weinstein-Korn-Miller, New York Civil Practice ¶203.25; Annot., 1 A.L.R.2d 630, 699-704 (1948) (cases where the party seeking to assert a set-off was in fact the plaintiff in a special suit brought to obtain it).

Where the Receiver's action was initially filed as a counterclaim to the Exchange's claim in Delaware receivership action, and dismissed for lack of state court jurisdiction to hear an Exchange Act claim, equity demands that the Receiver be allowed to state it here, at least as a set-off to the counter-claim on which the Exchange has been granted summary judgment.

CONCLUSION

The decision of the Court below should be affirmed and this case remanded for further proceedings.

Respectfully submitted,

SPENGLER CARLSON GUBAR
CHURCHILL & BRODSKY
Attorneys for Plaintiff-Appellee
Aubrey B. Lank as Receiver of
Pickard & Company, Incorporated
280 Park Avenue
New York, New York 10017

Of Counsel:

Robert S. Carlson
William F. Tueting
Gregory Katz
Robert D. Marafioti

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MILBANK, TWEED, HADLEY & McCLOY
ATTORNEYS FOR Appellant